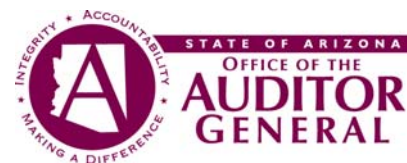


A REPORT
TO THE
ARIZONA LEGISLATURE

Accounting Services Division

Procedural Review

Cochise Elementary School District No. 26



Debra K. Davenport
Auditor General

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AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

April 26, 2006

Governing Board
Cochise Elementary School District No. 26
P.O. Box 1088
Cochise, AZ 85606-1088

Members of the Board:

We performed a procedural review of the internal controls of Cochise Elementary School District No. 26. The purpose of a procedural review is to determine whether a district is in substantial compliance with the *Uniform System of Financial Records for Arizona School Districts* (USFR). Our review consisted primarily of inquiries, observations, and selective testing of accounting records and control procedures. The review was more limited in scope than would be necessary to express an opinion on the District's internal controls. Accordingly, we do not express an opinion on its internal controls or ensure that all deficiencies were disclosed.

As a result of our review, we noted significant deficiencies in internal controls that indicate the District has not complied with the USFR. District management should implement the recommendations we have described in this report within 90 days after the date of this letter. We have communicated specific details for all deficiencies to management for correction.

Further, as of the date of this letter, we have not received the District's audit reports for the two years ended June 30, 2005, and USFR Compliance Questionnaire for the year ended June 30, 2005. These reports were due by March 31, 2006. Consequently, the District has not complied with the USFR and state law in regard to report submission. If the District does not submit the reports and questionnaire within 90 days of the date of this letter, we will notify the Arizona State Board of Education of the District's noncompliance and request that appropriate action be taken as prescribed by Arizona Revised Statutes §15-272.

During the 90-day period, the District may request a meeting to discuss these recommendations with my Office and the Arizona Department of Education by calling Magdalene Haggerty, Accounting Services Director, or Gregg Rickert, Accounting Services Manager.

Governing Board
Cochise Elementary School District No. 26
April 26, 2006
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A member of my staff will call the Superintendent in several weeks to discuss the District's action to implement these recommendations. After the 90-day period, my staff will schedule an on-site review of the District's internal controls to determine whether the District is in substantial compliance with the USFR. Our review will cover the deficiencies we have communicated to management as well as any other internal control deficiencies we are aware of at the time of our review.

Thank you for the assistance and cooperation that your administrators and staff provided during our procedural review. My staff and I will be pleased to discuss or clarify items in this report.

Sincerely,

Debra K. Davenport
Auditor General

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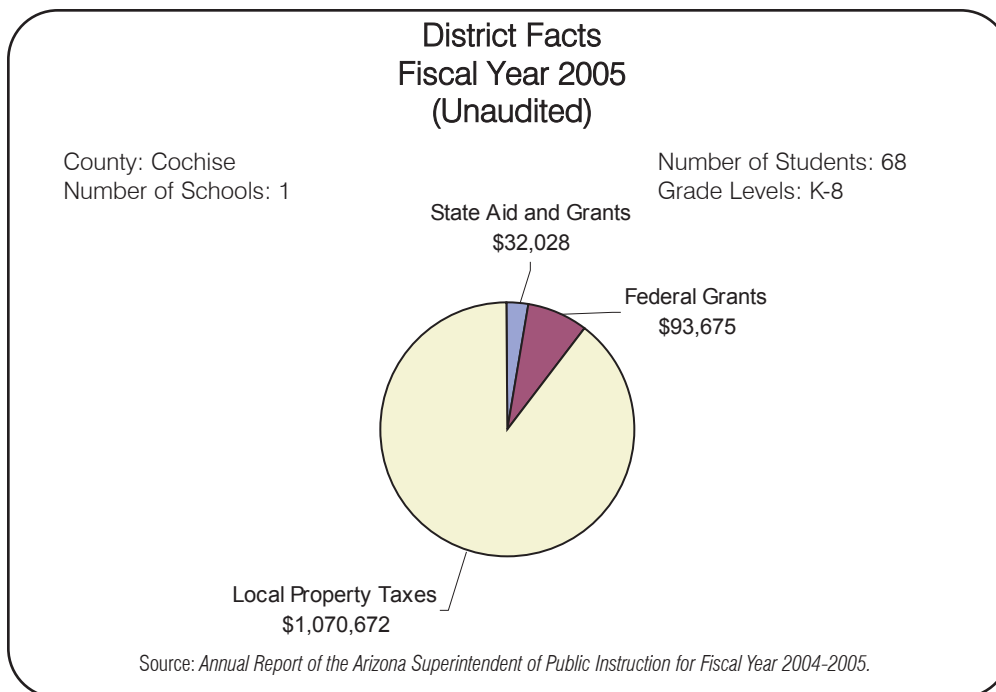
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INTRODUCTION

Cochise Elementary School District No. 26 is accountable to its students, their parents, and the local community for the quality of education provided. The District is also financially accountable to taxpayers for approximately \$1.2 million it received in fiscal year 2005 to provide this education.

The District should use effective internal controls to demonstrate responsible stewardship for the tax dollars it receives. These controls are set forth in the *Uniform System of Financial Records* (USFR), a joint publication of the Office of the Auditor General and the Arizona Department of Education (ADE). The policies and procedures in the USFR incorporate finance-related state and federal laws and regulations and generally accepted accounting principles applicable to school districts. Districts are legally obligated to comply with USFR requirements, and doing so is good business practice.

As a result of our procedural review, we determined that the District had not complied with the USFR. We noted certain deficiencies in controls that the District's management should correct to ensure that it fulfills its responsibility to establish and maintain adequate financial stewardship and to comply with the USFR. Our recommendations are described on the following pages.



The District's controls over cash should be strengthened

Poor cash controls left district monies susceptible to loss, theft, or misuse.

Because of the relatively high risk associated with cash transactions, the District should have effective internal controls to safeguard cash and ensure that revenues are properly recorded. However, the District did not have strong controls over its cash receipts and bank accounts. For example, the District did not adequately separate cash-handling and recordkeeping responsibilities and did not document or record all cash receipts. Specifically, employees authorized to sign checks had access to unused checks, and a check signer for each account prepared checks, recorded transactions, and reconciled the account. Additionally, the District did not always issue receipts or otherwise document cash received; failed to properly deposit and record extracurricular activities tax credit monies, miscellaneous revenues, and refunds; and made disbursements from those monies without proper documentation, and for inappropriate purposes.

Recommendations

To help strengthen controls over cash, the District should:

- Separate cash-handling and recordkeeping responsibilities between employees so that no one employee controls all aspects of transaction processing. Check signers should not have access to unused checks and should not be responsible for reconciling bank accounts. If one employee is responsible for incompatible tasks, a district manager or supervisor should review and approve the monthly bank reconciliations.
- Issue prenumbered cash receipts or use a cash register to document cash received. Deposit cash receipts intact daily, if significant, or at least weekly in appropriate bank accounts or directly with the County Treasurer.
- Use the Miscellaneous Receipts clearing account to temporarily deposit miscellaneous monies that the District receives directly. Remit such monies to the County Treasurer at least monthly and record the related revenues in the appropriate funds.
- Deposit extracurricular activities tax credit monies received in either the Auxiliary Operations bank account or with the County Treasurer in the Extracurricular Activities Fee Tax Credit Fund. Additionally, ensure that tax credit monies are used only for expenditures related to extracurricular activities or character education, and subject to donor restrictions.

- Issue checks from the Maintenance and Operation (M&O) Fund revolving account only for expenditures that require immediate cash outlays, such as travel, freight, or postage.
- Maintain the M&O Fund revolving account on an imprest basis and make deposits to replenish the account only by warrant drawn on the District's M&O Fund when supported by vendor invoices for checks issued from the revolving account.

The District should improve controls over student activities monies

The District holds student activities monies raised through students' efforts for safekeeping. The Governing Board is responsible for establishing oversight for these monies to ensure that proper procedures are followed for collecting and spending them. However, the Governing Board did not establish proper oversight. Specifically, the District did not issue prenumbered cash receipts or tickets for cash collections, prepare cash collection reports, or ensure that all cash receipts were recorded in the check register. In addition, the Governing Board did not appoint a student activities treasurer, and the District did not ensure that student activities checks were signed by two authorized signers. Further, student activities disbursements were not always supported by club minutes, and supporting documentation was not always checked for mathematical accuracy or canceled when paid.

The District did not safeguard monies raised by students from the possibility of loss or theft.

Recommendations

To strengthen internal controls over student activities monies, the District should establish the following procedures:

- Prepare prenumbered and numerically controlled cash receipt forms when cash is received. As an alternative, employees may record receipts on a cash register, issue tickets, or count items before and after a sales event. For events for which documenting items sold is not practical, such as bake sales, employees should still document the amount of cash collected.
- Prepare and retain cash collection reports to reconcile sales to cash collections.
- Record all deposits and disbursements in the check register.
- Have the Governing Board appoint a student activities treasurer.

A sample student activities cash collection report is on USFR page X-H-21.

- Require all student activities checks to be signed by the student activities treasurer and one other authorized signer.
- Ensure that student activities disbursements are approved by the appropriate student club and documented in its minutes.
- Check all vendor invoices for mathematical accuracy and cancel them when paid to help avoid duplicate payments.

The District should strengthen controls over expenditures

The District's former superintendent was overpaid at least \$6,500 for unqualified travel expenses claimed between July 2001 and April 2005.

The District spends tax dollars to pay its employees and purchase goods and services, so it is essential that the District follows procedures designed to help ensure that all expenditures are appropriate and adequately supported and that it receives the best possible value for the public monies spent. However, the District did not ensure that all expenditures were appropriate and served a documented public purpose. Specifically, the District spent over \$4,600 for employee parties and gifts since September 2000. Further, the District often reimbursed employees for meals and mileage based on incomplete travel claims, at the wrong rate, and when no travel reimbursement was allowed based on state guidelines. Also, the District did not require hourly employees to prepare and submit timecards.

The District also did not always follow the USFR's competitive purchasing guidelines and did not always retain documentation to support expenditures. Specifically, the District did not always obtain oral price quotations for purchases that required them and did not ensure that purchases it made through a purchasing cooperative were bid in accordance with the School District Procurement Rules. Additionally, the District did not prepare receiving reports for all appropriate goods and services purchased.

Recommendations

To strengthen controls over expenditures, the District should:

- Pursue repayment of inappropriate travel reimbursements made to district employees.
- Ensure and document that public monies are not spent for the benefit of private individuals unless there is a public purpose served by the expenditure and the value is not far exceeded by the amount paid. The Governing Board should

ensure that expenditures do not violate the gift of public monies clause in the Arizona Constitution, Article 9, §7.

- Ensure that travel claims are completed accurately and paid in accordance with the Arizona Department of Administration's travel policy §II-D and at appropriate reimbursement rates. Travel claims should include dates and times of travel and odometer readings for mileage claimed. When employees traveling on district business begin or end travel at residences, mileage reimbursement should be computed as the mileage for the most direct route to the destination after subtracting the commute mileage to or from the employee's designated duty post. Additionally, employees should not be paid per diem for meals that are provided at conferences or meetings at no cost to the employee.
- Require classified employees to prepare timecards each pay period to document the number of hours worked. Supervisors should review and sign all timecards as support for amounts paid and vacation or sick leave used.
- Obtain oral price quotations from at least three vendors for purchases estimated to cost between \$5,000 and \$15,000, and written price quotations from at least three vendors for purchases estimated to cost between \$15,000 and \$33,689. The purchase may be a single purchase, or may be a collection of items that, in the aggregate, exceeds the threshold. If the District cannot obtain three price quotations, it should document the vendors contacted and their reasons for not providing quotations.
- Perform and document the due diligence procedures performed for a sample of the purchasing cooperative's contracts that the District plans to use. This will help ensure that cooperative contracts were bid in accordance with the School District Procurement Rules.
- Prepare receiving reports for all appropriate goods and services before payments are made to vendors to document that the items were received, inspected, and approved for payment.

USFR Memorandum No. 176 and the Arizona Accounting Manual, Travel Policy, §IID provide guidance on allowable travel expenses.

USFR guidelines require:

- Oral price quotations for purchases between \$5,000 and \$15,000.
- Written price quotations for purchases between \$15,000 and \$33,689.

The District must use its Classroom Site Fund monies properly

The Classroom Site Fund (CSF) was established in fiscal year 2002 to account for the portion of state tax collections provided to school districts as additional funding for teacher salary increases and other specified maintenance and operation purposes. Districts must correctly allocate, separately account for, and spend CSF monies in

The District inappropriately paid CSF monies to its superintendent, maintenance and food service employees, and bus drivers.

accordance with Arizona Revised Statutes (A.R.S.). However, the District did not properly spend CSF monies, since it paid employees who did not provide instruction to students approximately \$1,000 each from two of the CSFs (Funds 012—Performance Pay and 013—Other) during fiscal year 2005.

Recommendations

The District should ensure that CSF monies are used for instructional purposes only, as provided in A.R.S. §15-977. Specifically, districts may use CSF monies for maintenance and operation expenditures for class size reduction; teacher compensation increases, including employment-related expenses; Arizona's Instrument to Measure Standards (AIMS) intervention programs; teacher development; dropout prevention programs; or teacher liability insurance premiums. The District may not use CSF monies for administrative and noninstructional purposes, and should ensure that the monies are used to supplement rather than supplant existing monies from all other sources.

USFR Memorandum Nos. 194 and 212 provide guidance on accounting for the Classroom Site Fund monies.

The District should maintain capital assets and stewardship lists

The District did not protect its investment in capital assets since it did not prepare capital assets or stewardship lists.

The District has invested a significant amount of money in its capital assets, which consist of land, buildings, and equipment. Effective stewardship requires the District to have accurate lists of these assets and to ensure that they are properly accounted for. However, the District did not have a capital assets list for items costing \$5,000 or more, or a stewardship list for items costing between \$1,000 and \$5,000. In addition, the District did not reconcile capital acquisitions to capital expenditures for the year ended June 30, 2004. Finally, the District's fiscal year 2005 physical inventory was not performed effectively and in accordance with the USFR guidelines.

Recommendations

The following procedures can help the District improve control over its capital assets and help ensure that accurate and complete capital assets and stewardship lists are maintained:

- Perform a physical inventory of all equipment items at least every 3 years following USFR guidelines. Retain all written instructions, inventory count sheets, and other documents relating to the physical inventory.

Instructions for performing a physical inventory of capital assets are listed on USFR pages VI-E-8 and 9.

USFR pages VI-E-2 and 3 describe information that should appear on the capital assets and stewardship lists.

- Prepare and maintain a capital assets list of all items costing \$5,000 or more with useful lives of 1 year or more, and a stewardship list of all equipment items costing between \$1,000 and \$5,000. Include all required information for each item on the lists.
- Retain cost documentation for all items on the capital assets list and verify that the cost of each item on the list agrees to such documentation. If the District cannot locate documentation to support the actual costs of assets, it may use estimated historical costs obtained from appraisals, bond issue documents, governing board minutes, or vendor catalogs.
- Assign an employee who has no custodial responsibilities to reconcile the physical inventory to the capital assets and stewardship lists, and add items to or remove items from the lists as necessary.
- Reconcile items added to the capital assets list during the fiscal year to capital expenditures, and make all necessary corrections.

The form on USFR page VI-E-13 may be used to document the reconciliation of capital asset additions to capital expenditures.